

Healthy Cities, Healthy Oklahoma: the Plight of Municipal Finance in Our State

Presented by:

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Overview of Oklahoma Municipal Government

» Municipalities as the Economic
Engine of the State

Oklahoma State and Local Governments

- ▶ State of Oklahoma
 - Population 3.6 million
 - Approximately 175 departments, agencies, commissions, authorities, or other related entities
- ▶ Oklahoma Local Governments
 - Approximately 1,880 local governmental entities
 - Counties – 77
 - Cities and towns – 585
 - School districts – 567
 - Other special districts and trust authorities – 651

Predominately Small Municipalities

Of the 585 Oklahoma municipalities:

- ❑ 319 have population under 1,000
- ❑ 200 have population between 1,000 & 5,000
- ❑ 58 have population between 5,000 & 50,000
- ❑ 5 have population between 50,000 & 100,000
- ❑ 3 have population over 100,000

Cities and Towns are the Economic Engine of the State

- ▶ **77%**
 - ▶ of all Oklahomans live in municipalities
- ▶ **91%**
 - ▶ of STATE sales tax is generated from sales within municipalities
- ▶ **80%**
 - ▶ of Oklahoma citizens & businesses receive water from municipal sources
- ▶ Virtually all commerce, government, education & healthcare occurs inside a city

Bottom Line

You cannot have a healthy Oklahoma economy without having healthy functioning cities and towns.

Municipal Funding Sources

» Oklahoma's Fundamentally
Flawed Model

Major Sources of Operating Revenue

STATE - 5		COUNTY - 3	
Income Tax		Ad Valorem	
Sales Taxes		State Apportionment	
Gross Production Taxes		Sales Tax	
Motor Vehicle Taxes			
Misc. Taxes			
SCHOOL DISTRICT - 3		MUNICIPALITY - 1	
Ad Valorem		Sales Tax	
State Appropriation			
Federal Appropriation			

How Do Other States Fund Municipalities?

6 states provide 3 sources of revenue from appropriations, ad valorem, income tax and sales tax

27 states provide 2 sources of revenue

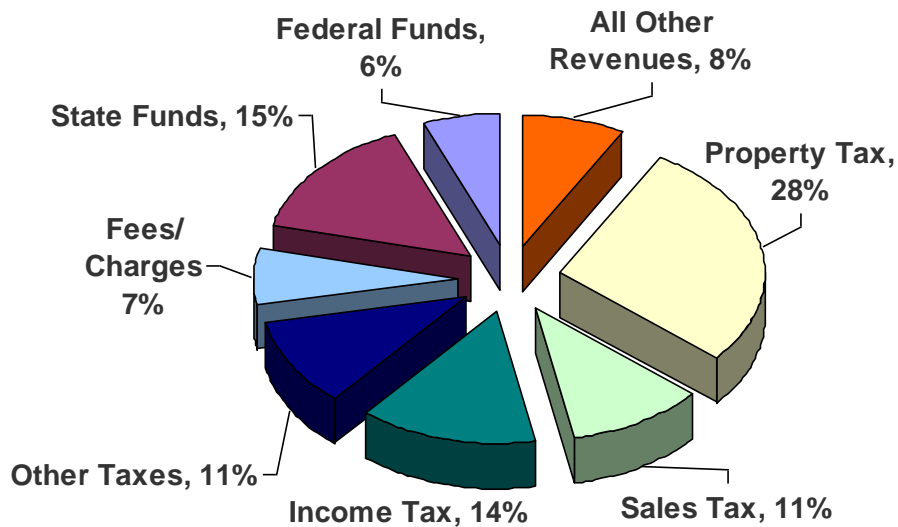
17 states provide only 1 source of revenue

Only in Oklahoma is that 1 source sales tax

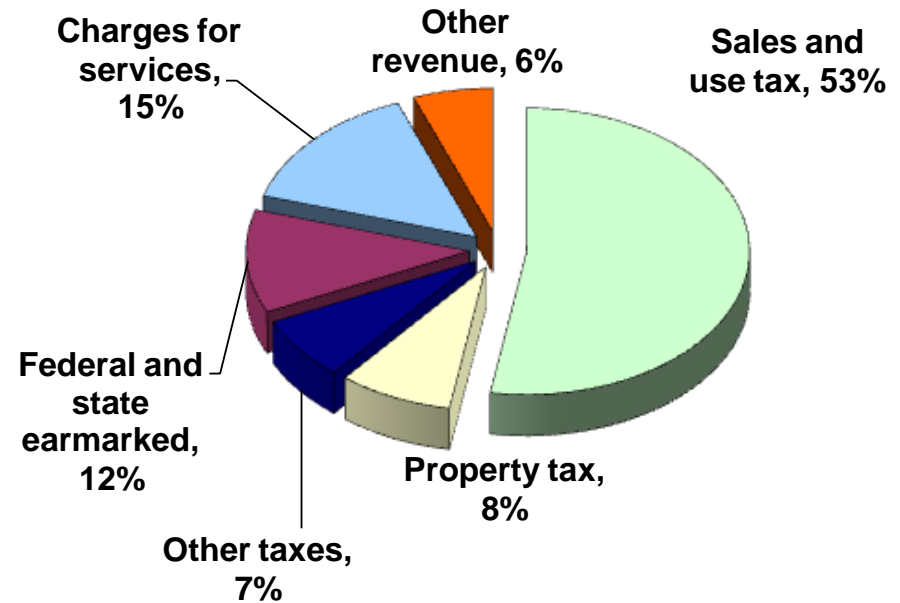


Comparison of U.S. to Oklahoma

US Municipal Revenue Sources



Okla. Municipal Revenue Sources



Note: Oklahoma amounts represent an average of six selected Oklahoma municipalities for FY 2009 governmental activities.

Limitations on the Ability to Levy a Property Tax

- ▶ Unlike counties and school districts, property tax levies for operating purposes by Oklahoma municipalities are not constitutionally provided
- ▶ Oklahoma municipalities may only levy a property tax for a Sinking Fund and then only under two circumstances:
 1. With voter-approval, to pay debt service (principal and interest) on general obligation bonds for capital improvements
 2. To pay principal and interest on judgments rendered against the municipality by a court
- ▶ The vast majority of Oklahoma municipal governments have no outstanding general obligation bonds nor fund judgments through a sinking fund; therefore they levy no property tax

Retail Sales versus New Jobs and New Rooftops

For fiscal survival, municipalities are forced to pursue retail sales over jobs and rooftops

- New jobs generate income tax
- New rooftops, after construction, generate only ad valorem (property) tax
- New rooftops generally mean more demand for service and more cost to municipalities without corresponding new revenue

The “Walmart” Effect

Annual Sales Tax Revenue Per Person Per Penny (PPPP) – Makes comparisons possible regardless of size of city or rate of tax

The average PPPP in a Walmart City is **\$139**

The average in a non Walmart is **\$72**

Example: For a 3,000 population municipality with a 3 cent sales tax rate, this means the difference in annual sales tax revenue of \$603,000 (\$1,251,000 in Walmart City and \$648,000 in non-Walmart City)

Source: 2006 Research Report by Wayne Trotter,
Pottowatomie County News

Do retail sales from new businesses generate NEW revenue?

When a municipality adds a new retail business, where do the shoppers come from?

- Often drains revenue from one locality to benefit another, or
- May merely shift revenue from one retailer to another within the same locality

Pits municipalities against one another, undermining regionalism and collaborative efforts

Pursuit of retail sales has limited benefit for the state as a whole, unlike pursuit of manufacturing and industrial development.

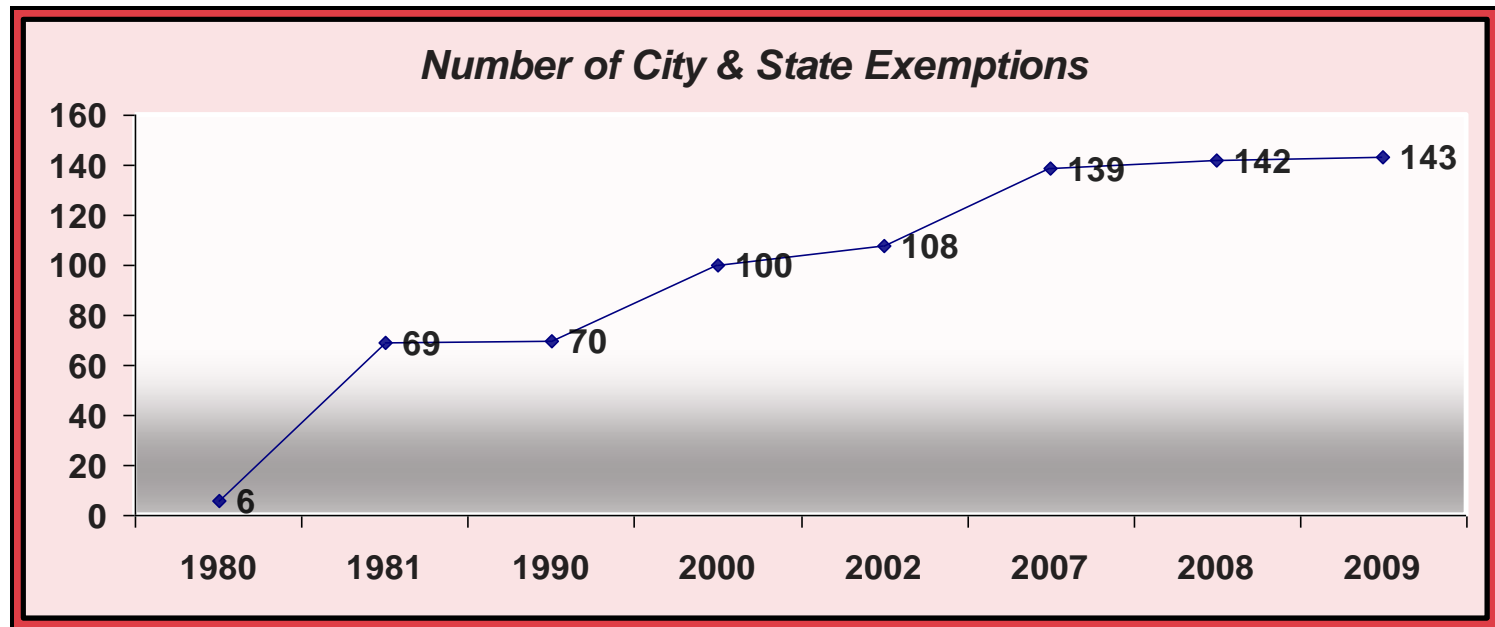
Problems with Sales Tax Reliance

- ▶ Sales tax is a volatile source of revenue, and lacks the relative stability of property tax
- ▶ Shifts in the economy from goods to services have left a decreasing share of sales in Oklahoma subject to the sales tax – just 35.7 % in 2003 vs. 52.0% in 1990
- ▶ Compounded by State–legislated tax exemptions over time -- up from 6 in 1980 to 143 in 2010

Problems with Sales Tax Reliance

- ▶ Emergence and growth of Tribal Commerce in our state has resulted in further leakage, as has sales thru vending machines (pay State permit in lieu of sales tax)
- ▶ Consumer switch to Internet sales is resulting in significant loss of sales tax
 - Internet sales nationally estimated at \$2.4 trillion in 2006
 - Sales tax loss nationally estimated to reach \$11.4 billion by 2012
 - Sales tax loss to Oklahoma state and local governments projected to be \$106 million annually by 2010 and \$125 million by 2011

Not Every Retail Sale Transaction Generates Sales Tax



Total value of state and local sales tax exemptions estimated at \$2.9 billion in 2006.

State, County Sales Taxes Crowd Out Cities' Ability to Increase

- ▶ From inception in 1930's till oil bust in 1982, the State sales tax rate remained at only 2.0 cents
- ▶ Increased multiple times in 1980's, now at 4.5 cents
- ▶ Counties began accessing sales tax in 1983. Legally, can be as much as 2 cents. Statewide, averages 1.25 cents
- ▶ Even schools have begun to gain access to the sales tax, in partnership with municipalities (e.g. Oklahoma City Maps 3, Lawton)
- ▶ Result: cumulative sales tax rates are approaching (and exceeding) 10.0% – among the highest in the nation

Not All Sales Tax is Available for General Government Operations

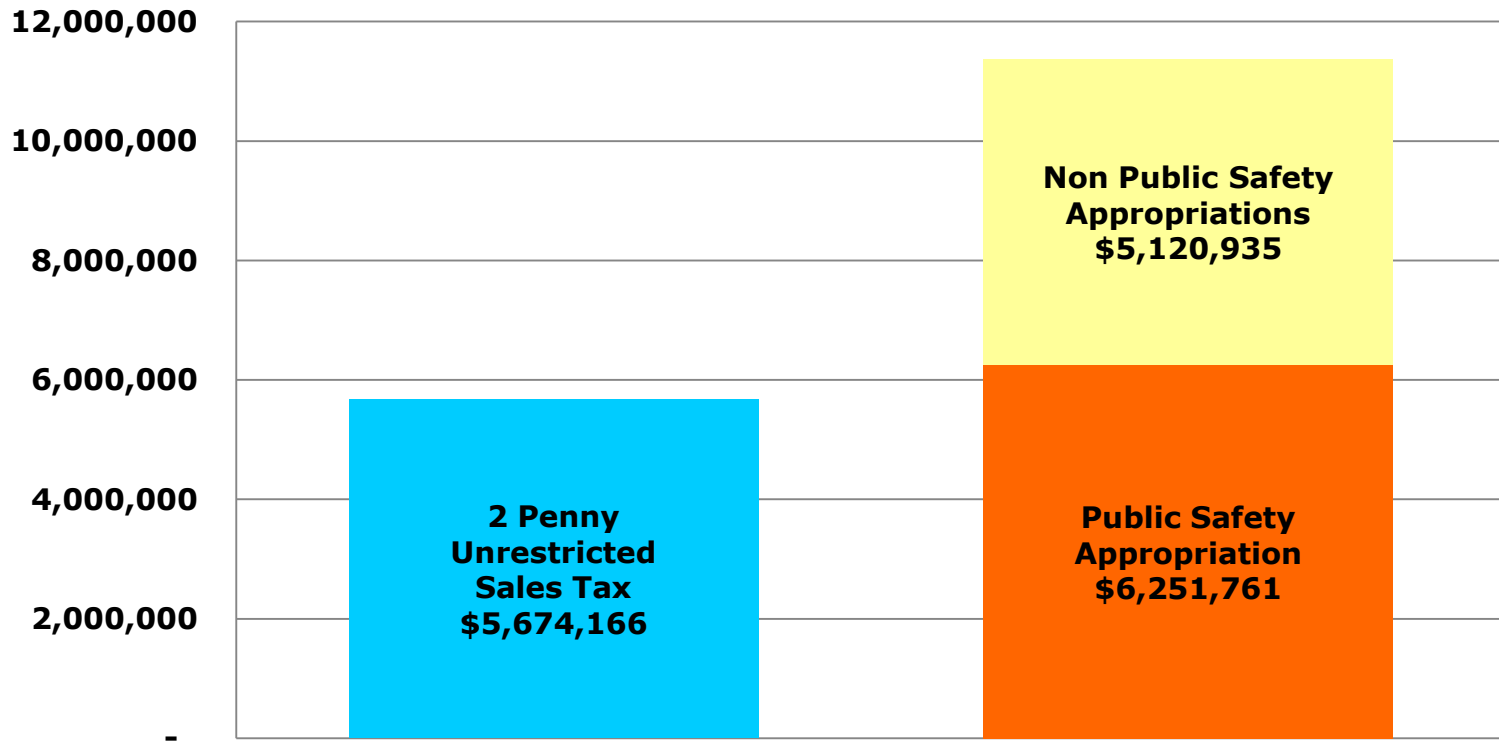
- ▶ All sales taxes must be voter-approved
- ▶ More often than not, sales taxes are now approved with voter-restrictions as to use, and some sales taxes include sunset provisions that discontinue the tax after a certain date
- ▶ Voter-restricted sales taxes are to be accounted for in a fund separate from the General Fund and must be used only for voter-approved purposes
- ▶ Even unrestricted sales taxes are often pledged for capital projects or retirement of long-term debt of business-type activities and may not be available for general govt operations

Inside City Hall

Voter-approved sales tax is often restricted

City	Portion Restricted	General Fund
Broken Arrow	1.5%	1.5%
Claremore	3.0%	0%
Collinsville	1.0%	2.0%
Jenks	1.0%	2.0%
Bixby	1.5%	2.0%
Owasso	1.0%	2.0%
Sand Springs	1.5%	2.0%
Sapulpa	2.2%	1.8%
Skiatook	1.0%	2.0%
Tulsa	1.0%	2.0%

City of Sand Springs General Fund Sales Tax vs General Fund Appropriations



In most Oklahoma municipal governments, unrestricted sales tax revenue is not even sufficient to fund their public safety costs.

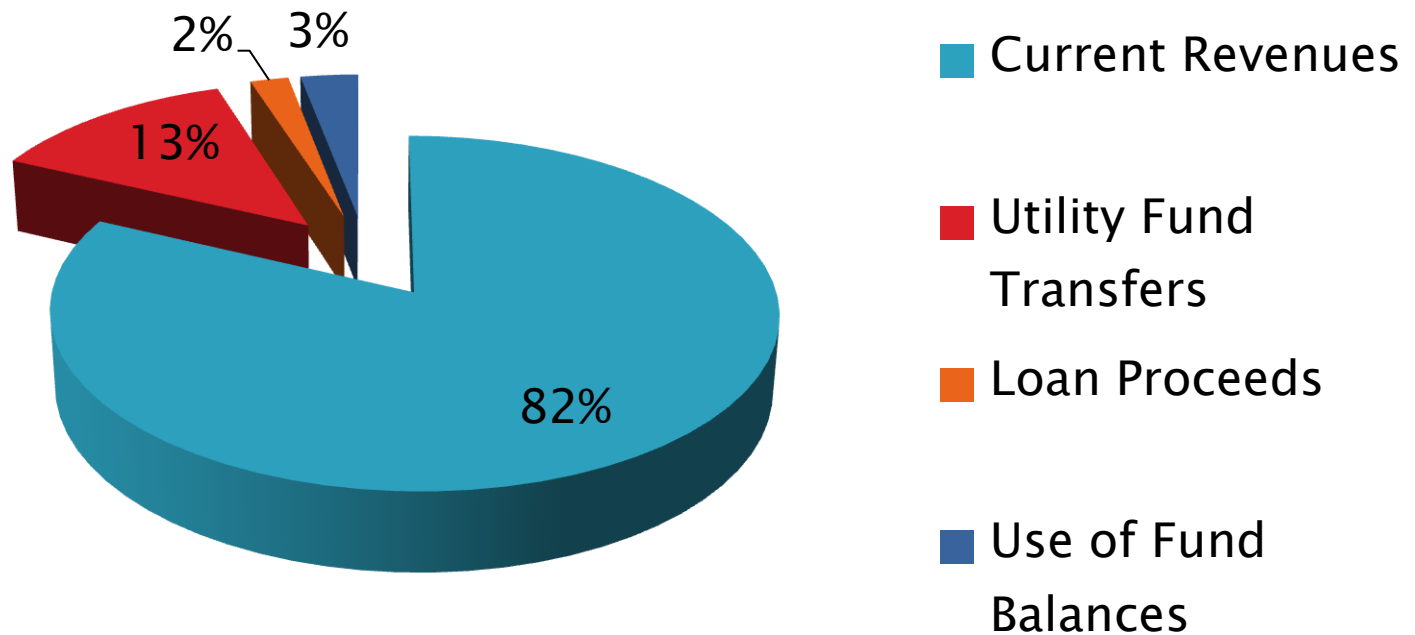
State Funding for Municipal Streets

- ▶ Municipal Roads Are Vital to Economic Development
 - Federal highway statistics indicate that 54% of miles driven in Oklahoma are driven on municipal streets
- ▶ State Tax Apportionments for Streets and Transportation Purposes
 - Counties \$325 million statewide
 - Municipalities only \$24 million statewide
- ▶ In one typical municipality, annual allocation of state tax apportionments is \$16,000, while cost to just light the streets is \$45,000
- ▶ Average cost to repave 1 city block is estimated at \$13,500

Balancing Municipal Budgets

»» Approaches and Consequences

How are Oklahoma municipal budgets for governmental activities being balanced?



Represents the average of six example Oklahoma municipalities for their Governmental Funds in FY 2010.

Budget Balancing Consequences

- ▶ Robbing utility and other business activities' revenues means:
 - Systems go without needed maintenance
 - **218 or 37%** of Oklahoma municipalities' water treatment facilities are under DEQ Consent Order; and another **216 or 37%** are under DEQ Notice of Violation
 - Compares to **4%** in Kansas
 - EPA estimates **\$5.4 billion** to bring municipal water and sewer up to standard statewide
 - Higher utility rates for customers
 - Utility customers are funding general government activities

What Can We Do?

»» Current and Future Initiatives

Healthy Cities Healthy Oklahoma Initiative

- ▶ Initially started by the Coalition of Tulsa Area Governments (CTAG) but spread statewide in 2009 and 2010
- ▶ Designed to:
 - Inform and educate government officials, the public, and the state legislature of the plight of municipal finance in Oklahoma and how important financially healthy cities and towns are to the state as a whole

Initiate action to provide short-term and long-term solutions to the flawed municipal funding structure

Healthy Cities Healthy Oklahoma Proposed Remedies

- ▶ First Do No Harm at the State Legislature
 - Learn the Cost of New State Mandates Placed on Cities and Towns Prior to Passage
 - State Legislature Passed a Bill in 2010 Requiring Municipal Fiscal Impact Statements (HB 3054)
 - HB 3054 Requires One Year Implementation Delay for Measures Having Adverse Impact Greater than \$100,000 Statewide, absent Emergency Clause (3/4ths vote)
 - Urge Moratorium on Any Additional Sales Tax Exemptions that Harm Municipal Governments

Healthy Cities Healthy Oklahoma Proposed Remedies

- ▶ First Do No Harm at the State Legislature (continued)
 - Require Quarterly Report on Office of Emergency Liabilities to Local Government for Reimbursement for FEMA Presidentially Declared Natural Disasters
 - Restore Counties' Ability to Partner with Municipalities on Street Projects
 - Convene a Municipal Finance Legislative Task Force to study the financing issues of municipal governments

Healthy Cities Healthy Oklahoma 2010 Legislative Response

- ▶ Legislature Begins Beefing Up Oklahoma Tax Commission for Sales and Use Tax Compliance
 - Added 10 Sales Tax Collection Agents, 10 Auditors, and several Accountants and Programmers
 - This a 20% increase in # of people collecting sales taxes
 - Authorized \$23 million computer upgrade
 - Increased emphasis on collecting delinquent sales taxes

Healthy Cities Healthy Oklahoma 2010 Legislative Response

- ▶ **HB 2539 Enhance Use Tax Collections**
 - Retailer Notice requirement to customers re: use tax
 - Notification requirements on tax preparers re: use tax
 - Expedites debt collection on overdue taxes
 - Mandates OTC collection of local sales and use tax
 - Mandates OTC jointly enforce with cities and counties
 - Allows independent audits to supplement OTC

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Proposed Remedies

- ▶ Local Enforcement Efforts Emerge
 - For the first time, OTC has begun allowing local governments to become active in enforcement of local sales tax. Some of the most active pioneers include:
 - Choctaw
 - Bartlesville
 - Muskogee

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Proposed Remedies

- How about Local *Collection* of Sales Taxes?
- City of Tulsa Considers Privatizing Collection of its Sales Tax
- OTC Secured Amendment to HB 2359 Final Hours 2010 Legislative Session to Remove Option for Municipalities to Collect Their Own Sales Tax
- Tulsa signed Agreement with Revenue Discovery Systems of Alabama June 1, 2010 before HB 2359 Became Effective
- Tulsa Filed lawsuit August 20, 2010 asking Court to declare HB 2359 Unconstitutional and Allow City to Privately Contract for Collection of Sales Tax
- RDS Proposed to Collect for 0.66%, While OTC Fee is 1.0%

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Proposed Remedies

- ▶ Oklahoma Municipal League Forms new Municipal Liaison Board to the Oklahoma Tax Commission
 - Municipal Goals: Improve accountability, reporting, and enforcement of sales and use taxes by OTC;
 - Improve understanding and cooperation between OTC and cities and towns;
 - Update and improve collection contracts between OTC and municipalities;
 - Identify and share best local analysis and enforcement practices among municipalities

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Proposed Remedies

- ▶ Fall 2010 Oklahoma Academy Town Hall on Municipal Government in Oklahoma Recommendations
 - Diversify the tax base by constitutional amendment, giving access to ad valorem for municipal operations
 - Broaden sales tax base to include some services
 - Increase city apportionment of State transportation related revenues, when State budget improves

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Proposed Remedies

- ▶ Fall 2010 Oklahoma Academy Town Hall on Municipal Government in Oklahoma Recommendations (continued)
 - Seek Independent Audit of OTC
 - Pursue Improved Performance of OTC
 - Allow Cities/Towns and Counties to Enter into Joint Purchasing Agreements
 - Eliminate the Statutory Requirement for Binding Interest Arbitration on Union Contracts

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Proposed Remedies

- ▶ Fall 2010 Legislative Municipal Task Force Recommendations
 - Diversify the Tax Base by Constitutional Amendment, Giving Access to Ad Valorem for Municipal Operations
 - Review and Sunset Some Current Sales Tax Exemptions and Enhance OTC Tax Collection and Audit Activities
 - Allow Cities/Towns and Counties to Enter Into Joint Purchasing Agreements
 - Eliminate the Statutory Requirement for Binding Interest Arbitration on Union Contracts

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Proposed Remedies

- ▶ Tulsa Metro Chamber's 2011 Regional One Voice Legislative Agenda
 - adopted by 35 different chambers and municipalities
- ▶ ***“Support legislation allowing municipalities to diversify their sources of revenue to fund essential governmental services”.***
 - ***Tulsa Regional One Voice Agenda, #2 Priority overall***

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Media Recognition of the Problem

- ▶ **EDITORIAL: *SOMETHING HAS TO GIVE REGARDING HOW OKLAHOMA CITIES ARE FINANCED***
- ▶ ***“A consensus is building on the need to do things differently at the local government level.”***
- ▶ ***“... (A) conversation is needed on the question of whether another leg needs to be added to the one-legged stool of municipal finance.”***
- ▶ ***“Oklahoma municipalities are operating with an antiquated, dysfunctional financing model”. County governments in the metro area are operating on an antiquated, inefficient governance model. Something’s gotta give.”***

– The Oklahoman Editorial, October 20, 2010

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Proposed Remedies

▶ 2011 Session Legislative Proposals

- SB 201 – Municipal Debt collection By Tag Agencies, Traffic Violations if Unpaid Result in Hold on Registration Renewals
- SB 286 – Creates dedicated “Municipal Sales Tax Enforcement Fund”, Halts Blending of Funds by OTC
- SB 614 – Authorizes Municipalities to Impose a Criminal Sanction For Willful Failure to Remit Sales Taxes Due
- SB 750 – Allows Local Governments to Use Outside Entities as Agents of the State to Collect Local Sales Tax

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Proposed Remedies

▶ 2011 Session Legislative Proposals

- SB 728 – Requires Inclusion of Sunset Provision on Any Future Sales Tax Exemptions
- HB 1044 – Modifies Legislative Rulemaking Process To Require Affirmative Approval if Increasing Agency Fees; Requires Demonstration of Statutory or Court Authority for Proposed Rules
- SB 216 – creates Task Force on the Collection, Distribution and Enforcement of Municipal Sales Tax to examine OTC processes
- HB 1593 – Repeals Municipal Employees Collective Bargaining Act for non-uniformed employees in cities > 35,000

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Proposed Remedies

- ▶ Potential Municipal Self-Help Solutions
 - Utilize Existing Municipal Authority to Create New/Expanded Revenue Sources
 - Partner with Others to Provide Services / Purchase
 - Reduce Service Areas to Only Within City Limits
 - Create and Fund Local Rainy Day Funds, When Possible, to Help Cope with Future Recessions

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Proposed Remedies

► Potential Future Legislative Solutions

- Authorize Municipalities Access to Ad Valorem Revenues on a Local Option Basis, perhaps to fund Public Safety
- Authorize Creation of Local Fire Safety Districts
- Continue to Beef up Oklahoma Tax Commission Enforcement Capabilities
- Return to Cities a Portion of the State Sales Tax Generated in its Area, e.g. Half-cent for local roads
- Increase motor vehicle apportionment for local roads

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Proposed Remedies

- ▶ Potential Future Legislative Solutions
 - Relax State Mandate that Requires Municipalities Provide Retirees With Same Health Insurance As Active Employees, but Caps Premiums at 125%
 - Create Permanent Funding Source for State Emergency Fund
 - Eliminate Certain State Sales Tax Exemptions
 - Reform State Pension Systems in Which Municipal Employees Participate, to Ensure Systems' Continued Viability
 - Enact Federal Main Street Fairness Act to Create Level Playing Field Between Local Brick and Mortar Retailers and Remote Sellers

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Proposed Remedies

► Broadening the State Sales Tax Base

- Would Enhance Long-Run Adequacy of The Sales Tax
- Would Improve Stability, Fairness, Reduce Distortions
- Taxing Services Primarily Consumed By Households, Exempting Those Consumed Primarily By Businesses Avoids Tax Pyramiding
- Annual Estimated New Revenues of \$792m (State) and \$580m (Local) in 2007 Source <http://okpolicy.org/fixing-sales-tax>
- Increased State Revenues Could be Used to Reduce State Tax Rates or Increase State Spending; Would Automatically Expand Local Sales Tax Collections

QUESTIONS?

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